Bandwidth is not the only appropriate measure of capacity. Newer digital systems, such as those to be utilized by PCS and ESMRs, provide far greater capacity than older analog systems.[98] Because existing cellular operators will be required to continue to meet their service obligations under analog before the conversion to digital,[99] they will have a lower effective capacity and market share per unit of allocated bandwidth than firms employing complete digital technology.[100] Thus, the effective share of the cellular carriers' capacity in the market will be less than their bandwidth share.

The investment community clearly believes that these new competitors will cut into cellular's market share. The market capitalization of ESMR companies as of Nov. 23, 1993 is consistent with the market expectation of competition with cellular.

	Company	Capitalization	1993 Increase
1.	Nextel	$6.5 Billion	282%
2.	Dialcall	$2.0 Billion	1150%
3.	CenCall	$1.1 Billion	187%
4.	Geotek	$0.5 Billion	412%

For example, Nextel is valued approximately at $50 per man, woman and child in each of the markets where it is anticipated to serve. Given current dispatch penetration, average revenue per month of less than $20, and growth rates of about 10-15% per year, these market capitalizations would be astronomically high if they were for dispatch

98 Besen and Burnett, supra, at 36; see also "U S WEST NewVector and Qualcomm Announce Plans to Form CDMA Subscriber Equipment Relationship" Business Wire, May 11, 1993; "Ericsson Takes the Lead in TDMA Digital Cellular System Installations," Business Wire, September 30, 1993.

99 Personal Communications Services, supra, 8 F.C.C.R. at 7715.

100 Besen and Burnett, supra, at 36.

(and limited SMR interconnect) only. However, they are consistent with values for cellular given their growth rates and average monthly revenues. Thus, the market clearly believes that ESMR will be competitive with cellular. Analysts' reports all consistently state that ESMR will compete with cellular:

> We think ESMR values could approach the levels cellular stocks command today ($150 to $200 per pop) within several years. ESMR companies enjoy capacity parity with analog cellular operators and may emerge as strategically better positioned to attract large corporate accounts than their cellular counterparts.[101]

Similarly, the intense interest in PCS from numerous sectors of American industry demonstrates that PCS will cut into cellular carrier's market share. Predictions similarly indicate vast demand for PCS:

> ". . . PCS subscribers could reach into the tens of millions within the next 10 years. There will be 60 million U.S. PCS subscribers at PCS' 10-year service mark, with 150 million or more worldwide subscribers . . . . Consumers have 'a need for real-time communications for both business and personal life,' and there exists a 'big, big consumer part of our society that hasn't been marketed or touched by cellular that PCS will penetrate . . . . PCS will explode [wireless demand] three to five times where we are now."[102]

Some commentators project PCS could reach 30-50% penetration after a relatively short period of time.[103]

The financial strength of the new entrants together with the capacity available to these competitors will certainly impact cellular carriers' market share.

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101 "Nextel Agrees to Acquire PowerFone," Prudential Securities, October 28, 1993.

102 PCS News, November 14, 1993, at 1.

103 BIS Strategic Decisions, "Mobile and Wireless Communications North America: Voice and Data Strategies," CTIA Field Trial results; FCC en banc PCS Public Hearing December 1992, at 7.

5. <u>The entrance of new competitors has enhanced competition</u>.

In analyzing flexibility for the interexchange market, the Commission observed that:

> . . . the ease of market entry and exit by competitors may be a more significant factor in determination of market power than is current market share . . . . Theoretically, a dominant firm will behave exactly like a competitive firm if there is a threat of entry by another firm, even if the dominant firm has a very large market share. 24 CPUC 2d at 560.

The Commission found that the barriers to entry in the interexchange market were not significant and the number of competitors continued to increase.

Similarly, in the new wireless market, the barrier to entry at the wholesale level--the FCC's duopoly market structure--has been eradicated and the number of competitors continues to increase as evidenced by the entrance of ESMRs such as Nextel and Geotek. Indeed, the experience of the Block A (nonwireline) carriers demonstrates the ease of market entry. The Block B (wireline) carriers had a "headstart" in the market. However, after Block A carriers began operation, they faced no difficulty in competing successfully.[104] The new entrants similarly will be able to compete effectively. Moreover, they are not saddled with the costly conversion to digital facing cellular carriers.[105]

Additionally, it is anticipated that cellular customers will be attracted to the new offerings. D. 93-02-010 at 49-50. In the cellular market, despite the high level of overall customer satisfaction with cellular service, customers have had exhibited a willingness to switch

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104 Hausman Affidavit at 14.

105 "ESMR territories can be built to conform to the best regional usage footprint right from the outset, saving time and money and creating a marketing edge in the process." "ESMR Invasion Spreads Across The Country," <u>The RSA Newsletter</u>, July 20, 1993, at 6.

carriers.[106] SMRs have maintained lower churn rates when compared to cellular and paging industries.[107] The customer's willingness to switch, combined with the supply of new competitors, will inhibit service providers' ability to raise rates.

Similarly, the existing cellular retail market has no barriers to entry or exit. The success of the resellers is attributable to almost nonexistent regulatory barriers to entry, and minimal capital requirements needed to obtain an efficient and profitable business and a profit umbrella mandated by the Commission. Numerous competitors have entered the cellular retail market in California and reported significant net incomes, without being required to provide the substantial investment required by facilities-based carriers. Competition has been further enhanced by distribution through multiple channels.

6. <u>Carrier earnings are not conclusive regarding competition</u>.

The Commission has recognized that, while relevant, carriers' earnings had limited value as a measure of competition in the interexchange market.[108] As the Commission observed, "[r]ates of

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106 "Nextel Introduces Digital Mobile Network to California Customers," <u>Advanced Wireless Communications</u>, September 15, 1993, at 10.

107 "SMR Industry Will Experience Continued Growth, Survey Finds," <u>Advanced Wireless Communications</u>, December 8, 1993 at 9.

108 All parties in the AT&T proceeding establishing the benchmarks pointed out the limitations of the use of earnings as a measurement of competition. The Commission noted that information on IECs' current earnings are of limited use:

> The OII recognized that a relevant earnings measurement may be difficult to devise, since the return on marginal investment at current replacement cost is the appropriate statistic, while recorded returns are measured relative to total embedded costs . . . . We conclude that the factors cited in the OII and by the parties make information regarding IECs' current earnings of

(continued...)

return vary for many reasons and do not per se indicate the absence of effective competition.[109] D.93-02-010 (mimeo) at 49. The CACD noted that "[r]evenues are, at best, a precarious measure of growth and/or market share because the profitability of interexchange carriers is not standard. The resulting measurements are unstable and not easily comparable."[110]

Cellular carrier earnings similarly are not a dispositive indicator of market competition, especially in light of the rapid changes which require continuous investment.[111] "Neither pricing patterns nor profits can indicate directly whether or not cellular carriers are competing fully with each other." D.90-06-025 at 49.

The OII's assumption that cellular carriers recover "monopoly profits" is also flatly at odds with the Commission's prior conclusions. After four years of examination of the cellular industry, the Commission found that "the record did not substantiate that cellular carriers are earning an excessive rate of return on their investment. D.90-06-025 at 10. The Commission rejected comparisons of cellular returns-on-investment to the monopoly telecommunications market, noting that the risk is substantially different between the markets and that current

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108(...continued)
limited use. However, consistent patterns in earnings over time would provide more reliable indications of the viability of a competitive marketplace. 24 CPUC 2d at 59.

109 In granting A&T increased flexibility in 1993, the Commission acknowledged AT&T's average return of 24% and observed that returns are reliable indicators over a period of time if viewed in tandem with other measurements of market power.

110 CACD Monitoring Report at 8.

111 See D.90-06-025 at 3; Metro Mobile CTS, Inc. v. New Vector Communications, Inc., 892 F.2d 62 (9th Cir. 1989); Metro Mobile CTS, Inc. v. New Vector Communications, Inc., 661 F. Supp. 1504 (D. Ariz. 1987).

earned rates of investment do not in and of themselves directly indicate whether rates are reasonable or unreasonable.

> Absent a risk analysis and a mechanism to measure a reasonable rate of return on cellular investment, there can be no finding that cellular carriers are earning an excessive return on their investment." Decision 90-06-025 at 50. See also 99, 101, 105 (Findings of Fact 82-85, 100, 101; Conclusion of Law 20).

Simple assumptions regarding the value of carrier's earnings as a measure of competition in the current dynamic market would be even more misguided. Given the rapidly depreciating network infrastructure due to the conversion to digital and the inherent problems in valuing spectrum, assessment of carrier's earnings as an indicator of competition remains problematic.

7. **Cellular carriers will require the flexibility to lower prices and improve quality in order to meet the competition.**

The Commission has acknowledged that customers' perceptions regarding the quality of service, changes in prices and the mix of available services are relevant to measuring competition. 24 CPUC 2d at 565. As demonstrated in section III.A.2 supra, cellular carriers compete effectively on the basis of price, service quality and product innovation.

This level of competition can only become more fierce with the new entrants. ESMRs and PCS will be able to offer service functionality equivalent to cellular. In response, cellular carriers will need to expedite development of product innovations, maintain service quality and implement strategies to differentiate themselves from the new competitors.

Additionally, the presence of ESMRs and PCS is expected to lead to a continuation of price competition and a long-term industry-wide reduction of price levels. In order to compete, cellular carriers require the flexibility to meet the competition on price. Lack of flexibility would be severely anticompetitive; cellular's current demand is elastic and thus would be depressed by an increase in price. Moreover, price elasticity is expected to increase with increased consumer penetration.

Indeed, since PCS began operation in the United Kingdom, cellular prices in the UK have decreased by about 20-33%.

> [T]here is little doubt that the price war shaping up in the UK will be coming to America in the 1990's . . . . Where the competition heats up, price wars across all facets of the business may be the rule rather than the exception.[112]

Similarly, Nextel claims that its "imminent arrival . . . has already benefited cellular customers and it has prompted our cellular competitors to initiate price reductions."[113]

In light of the new broader nature of the wireless market, the financial resources of the competitors and the functionality and breadth of coverage offered by the new services, it appears that already intense competition is accelerating. The Commission cannot rely upon a mere assumption that cellular carriers will have market power requiring restrictive regulation. In the dynamic new wireless marketplace, continued restrictive regulation applied to select competitors will lead to unnecessary delays, increased costs to wireless providers, and inevitably will decrease competition.

C. California cannot afford the legacy of dominant regulation in the wireless market.

It is clear from a review of the benchmarks that the old FCC mandated duopoly market structure is no longer the relevant starting point to

112 Cellular Investor, June 24, 1993, at 8.

113 Nextel 1993 Annual Report at 7.

evaluate future regulation. The entry of ESMRs and PCS will have a significant impact on competition in the wireless market in terms of market share, subscriber churn, penetration, price and capital expenditures. Cellular carriers must respond to the new competition, and regulation is most likely not needed at all.[114] With two cellular providers, one ESMR provider, and seven PCS providers, market competition will provide the means to "protect" consumers. Imposition of dominant regulation under such circumstances will only undermine the innovation and competition the Commission seeks to promote.

1. <u>Dominant regulation handicapping certain carriers will reduce competition</u>.

The dominant/nondominant classification ignores the importance of establishing a level competitive playing field to ensure the vitality of the market. The OII argues that "[t]he fact that different providers of mobile services may all be providing functionally identical services says nothing about who controls market power" as a result of the "semi exclusive licensing arrangement in cellular." OII at 17. This argument is simply factually incorrect. The OII <u>itself</u> recognizes that the "semi exclusive licensing arrangement" is a thing of the past. "[C]ellular technology is but one method for delivering mobile services . . . we will consider the extent to which different technologies provide competitive substitutes to each other and whether symmetrical or asymmetrical regulation treatment should apply." <u>Id.</u> at 8.

Moreover, the OII fails to acknowledge the importance of comparable regulation for competing services. Differential regulatory treatment for competitors providing similar services will create economic

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114 <u>See</u> "Market for Carriers," <u>Cellular Business</u>, December 1993, at 24, 26.

inefficiencies and the potential for anticonsumer pricing. The penalty of misguided regulation could be severe for California if investment decisions are driven by a government imposed unequal distribution of obligations rather than by market forces.

The disparate treatment of the competitors, as set forth in Appendix B, is dramatic. "Nondominant" carriers, including ESMRs, PCS providers and resellers, will be subject to "an informational registration requirement," requiring basic business information and must agree to abide by "minimum safeguards."

In contrast, "dominant providers" would be subject to monopoly utility cost of service regulation. The Appendix labels itself "price cap regulation," but it proposes garden variety rate of return regulation,[115] a form of regulation already rejected by this Commission for large monopoly local exchange carriers because of its counterproductive tendencies in competitive markets.

The disparate treatment proposed in the OII is contrary to the Commission's goal to maintain a level playing field in the face of competition:

> [W]e must be mindful of protecting competition rather than particular competitors, because the public can also be harmed by the extra cost of maintaining preferred market positions through regulation. Where competition exists, we should encourage its continuance through fair and limited measures intended only to prevent harm to consumers. D.90-06-025 at 17.

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115 While the OII solicits comments on alternative forms of regulation, Appendix B adopts a rate of return proposal. Dominant carriers would be subject to a price cap mechanism determining the maximum weighted price of "bottleneck rate elements." An initial weighted price cap level would be imposed by determining an estimate of the "reasonable" operating costs of each carrier, a standard valuation for each CGSA of the spectrum held by the carrier plus an "appropriate rate of return." OII Appendix B at 1-2.

Similarly, differential treatment of mobile service provided is contrary to the intent of both Congress and the FCC to treat functionally equivalent services alike. In amending section 332 of the Communications Act of 1934, Congress recognized the competitive realities of the mobile telecommunications marketplace and sought to remedy the disparate regulatory treatment of mobile services by requiring parity for functionally similar services.[116]
Thus, Congress established uniform rules to govern commercial mobile services.[117] Congress recognized that regulatory disparity would likely impair "the continued growth and development of commercial mobile services and denying consumers the protection they need."[118] In accordance with this intent, the FCC has adopted an order "creating regulatory symmetry between similar mobile services and to avoid imposing unwarranted regulation upon even those services classified as CMRS [Commercial Mobile Radio Services]."[119] The OII would ignore the intent of both the Congress and the FCC and impose disparate regulatory treatment on a select group of competitors.

A market in which only <u>some</u> of the competitors are subject to regulation is an inherently uneven playing field with the potential for anti-consumer pricing anomalies. ESMRs and PCS providers inevitably

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116 "Functionally . . . 'private' carriers have become indistinguishable from common carriers but private land mobile carriers are subject to inconsistent regulatory schemes." H.R. Rep. No. 103-111, 103rd Cong., 1st Sess., 1993, at 260.

117 <u>Id.</u> at 259.

118 <u>Id.</u> at 260.

119 The FCC has classified private carrier paging, common carrier paging, PCS, cellular and 800 MHz air ground services as CMRS because they meet the statutory definition. FCC News Release, "FCC Clears Way for Licensing of PCS; Provides Framework for Competitive Mobile Communications Market," Rpt. No. DC-2564, February 3, 1994.

will utilize market segmentation to create incentive programs prohibited by the Commission for "dominant" providers. The new competitors will be free to change prices without prior notice and to grant immediate price concessions to favored customers. Cellular carriers will be unable to respond by meeting or beating the competitor's price reductions. While the regulated carriers will obviously be unfairly handicapped, the real losers will be cellular customers, as regulated carriers are driven from the market and consumer choice is reduced.

2. <u>The arbitrary dominant classification will retard technological innovation</u>.

California must have a telecommunications infrastructure capable of participating in the national and international "superhighway."[120] As the lines between core businesses blur, once divergent industries have now aligned to offer wireless products and services. Cellular carriers must have an incentive, through competitively comparable returns on investment, to develop innovations to respond to these new alliances.

A dominant/nondominant structure which decreases a cellular carrier's incentives to invest, as compared with other competitors, is flatly at odds with the Commission's goals:

> California's telecommunications infrastructure strategy must be flexible enough to survive, and indeed encourage, rapid change in both types of technologies used and the ways in which consumers choose to use them. The telecommunications industry is and will continue to be subject to a punishing rate of technological

120 As Vice President Gore recently observed, "The wireless industry has a vital, expanding role to play in bringing this infrastructure into being. . . . [The information superhighway] will be a network of networks . . . using different technologies for different needs," and wireless will be particularly important in solving "the last-mile problem. Americans will want information where they are, and that's why for people on the move, wireless is going to be the answer in many cases. . . . If fiber optics networks will be the information superhighways, wireless will be the information skyways." <u>See</u> <u>PCS News</u>, October 14, 1993, at 8.

> innovation. Recognizing the difficulty of "predicting" futures under these conditions, this Commission rejects an interventionist approach to infrastructure development based on micromanagement or command-and-control regulation. Rprt. to Gov. at vii-viii.

> . . . [W]e encourage innovation which improves the quality and efficiency of service provided in California, and increases the range of choices available to satisfy the diverse needs of its population. We also seek to create an environment which encourages cost effective investment in advanced mobile telecommunications that expand the capability, capacity and coverage of mobile telecommunications in California. . . . The regulatory framework we adopt should recognize the rapid pace of advancements in technological efficiency and capabilities in mobile services and the long term benefits competitive diversity and service innovation may provide. OII at 14.

Despite recognizing the importance of technological innovation, the OII proposes a dominant/nondominant structure stripping certain service providers of incentives, comparable to the competition, which are necessary to invest in innovation. The result of this disparate treatment will ultimately be the limitation of customer choice.

Denying cellular carriers the incentives to invest in research and development will lead directly to a degradation in service. Cellular carriers are near capacity limits in major California markets and thus are continually investing in new technologies to extend and enhance their current analog networks, as well as planning to deploy digital technology. Carriers should be free to invest in innovative digital technology. As discussed earlier, PacTel has chosen to distinguish itself from the competition by employing CDMA as the digital technology for its networks. Carriers should have adequate incentives to develop alternative technologies and thus expand customer choice. Indeed, the Commission has recognized both the benefits of digital technology and the need for pricing flexibility:

> For the near term, our regulatory framework must be flexible enough to accommodate the substantial increases in capacity that digitalization will permit along with concomitant price decreases for customers. There is also the issue of the likely obsolescence

> of the customer premises equipment (CPE) or cellular telephone sets that now function on analog technology and are unusable for digital. D.90-06-025 at 7-8.

A dominant classification coupled with rate regulation will inhibit carriers' ability to deploy the new services critical to meeting versatile offerings of PCS and ESMR providers, and will severely reduce research and development opportunities. Providers must have the incentives of returns on investments comparable to the competition in order to convert to digital, provide quality service and introduce innovations of value to customers.

> Technological advancement can best be encouraged by providing cellular carriers the means to attract capital necessary to make investments in research, development, and commercialization of innovative technology. Allowing cellular carriers to retain all returns on investment earned through the competitive provision of service encourages technological advancement, the expansion of service to new customers, and reductions in unit costs. D.90-06-025, Findings of Fact 19-20 at 88. <u>See also</u> Findings of Fact 14, 17-20 at 93-94.

Accordingly, the Commission has concluded that:

> "California must reward innovation . . . [A]gencies should take the steps necessary to: (1) align incentives embodied in their policies to encourage innovation and facilitate experimentation (footnote omitted); (2) <u>remove unnecessary barriers</u> to the introduction of new services and products; and (3) <u>streamline regulations</u> governing telecommunications products, services and related applications." (emphasis in original). Rprt. to Gov. at 7-8.

The proposed dominant/nondominant framework is flatly at odds with these goals.

IV. <u>RELAXED REGULATION IMPLEMENTING A MONITORING PLAN IS THE ONLY FRAMEWORK TO MEET THE COMMISSION'S GOALS</u>. (Appendix A, Questions 11, 14, 20, 24, 25, 26, 28, 29, 47, 48).

In the face of increased competition in the interexchange market, the Commission has relaxed regulation and implemented an effective monitoring program to measure competition. Ironically, in the wireless market where no single carrier will have a majority market share as does AT&T, the OII proposes to increase regulation. California cannot afford rate regulation which will inevitably stifle both competition and innovation. The Commission should adopt a forward looking form of regulation, allowing increased flexibility while monitoring trends to protect consumers.

A. Rate regulation makes no sense in a competitive market.

1. Cost based regulation will undermine competition and retard innovation.

The OII confuses rate of return regulation with price caps. Under the cost based "price cap" alternative set forth in Appendix B, the Commission would determine a standard operating cost for cellular carriers, a market value for spectrum and impose a rate of return component on this formula. The OII implies that cost based regulation is preferable to indirect regulatory measures because it acts as "a direct constraint on the exercise of market power." OII at 21. It would be outrageous to impose such regulation based on the unfounded assertion of cellular market power in the broader mobile telecommunications market.[121] Traditional rate of return regulation or other types of cost based regulation are efficient only in traditional monopoly situations. Such regulation does not work in competitive

121 The OII suggests cost based regulation modeled after the LEC formulas. However, such regulation is entirely inappropriate for a discretionary service. Contrary to the assumption in the OII, there is no evidence that cellular carriers receive monopoly returns necessitating cost based regulation. *See* OII at 21. Moreover, as the chairman of the FCC recently observed, "continued rate regulation of previously dominant carriers may prevent the local market from becoming effectively competitive." Statement of Reed E. Hundt before the United States House of Representatives Subcommittee on Telecommunications and Finance, Committee on Energy and Commerce on H.R. 3636 and H.R. 3626, January 27, 1994.

situations due to its inherent perverse economic consequences and the inability to account for competitive factors that may arise.[122]

Indeed, the Commission extensively examined a variety of regulatory options and concluded that cost of service/rate of return regulation would be neither efficient nor workable for cellular carriers in the old duopoly framework. Even then, the Commission found that "[C]ost of service regulation of wholesale prices is problematic in a competitive industry like cellular that is undergoing rapid technological change." D.90-06-025 at 15.

> "The direct control of cellular prices through cost of service or rate of return regulation is inconsistent with the most important regulatory goals of promoting technological advancement, the expansion of service, and economic efficiency. . . . [These goals] would be best sought through indirect control of prices through regulatory requirements to expand cellular systems as rapidly as possible and to price so as to fill available capacity with customers. . . . Decision 90-06-025 at 100 (Findings of Fact 90, 91).

In the new wireless marketplace with significant new entry and technological change, rate of return regulation on some or all competitors would be a serious mistake for California. Rate of return regulation discourages investment by carriers and thus eliminates choices for consumers.[123] Cost based regulation is also problematic in

122 The Commission has repeatedly recognized the difficulties of implementing cost based regulation in other contexts. In D.89-10-031, the Commission cited fundamental concerns regarding rate of return regulation for <u>local exchange companies</u> in light of the dynamics of competition and new technology. <u>See</u> 33 CPUC 2d 43, 92-134. It is incredible that the OII proposes such regulation for the even more competitive wireless industry.

123 Regulated companies will not adopt new technologies given the economic life of the technology remaining in use. Conversely, adjustment of regulatory lives will lead to regulatory reserves or stranded investment, ultimately causing prices to rise. Asymmetric treatment of investments will also undermine innovation. Unsuccessful technology may be excluded as part of a prudency review while successful technology will not result in a commensurate benefit.

industries requiring rapid technological development.[124] The OII proposes to establish "a standard operating cost." OII at 20. The cellular industry is anything but standard. Such a measurement would make preposterous assumptions about behavior, transplanting an assumed surrogate for the diverse and lightning pace of technological change. The OII recognizes that "it is difficult to measure economic investment and expansion." OII at 11. Similarly, it is difficult to measure economic risk of service. Cost of service measurements only work in relatively stable technologies where the assumed depreciation of capital makes economic sense and in fact have only been utilized in monopoly environments. Such regulation is totally inconsistent with the pace of both technological and competitive changes in the wireless industry.

Cost based regulation, based on an industry average, is also problematic because it fails to recognize carriers' different cost structures. The problem was serious in a duopoly market--it is insurmountable in a market with numerous competitors.

> The duopoly wholesale carriers in a given market have different system configurations and therefore different cost structures. Any regulatory approach to setting wholesale rates through cost of service calculations will necessarily produce different prices for the two systems if the allowed rates of return are the same for each. . . . caus[ing] the higher-priced carrier to lose customers and depriv[ing] that carrier of a reasonable opportunity to earn the rate of return based on which its price was set . . . . Id. at 93-94 (Findings of Fact 17, 18).

Alternatively, cost based regulation, predicated on each carrier's average cost, can eliminate incentives to minimize costs and improve

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124 As the Commission recognizes, investors need incentives to take the risks inherent in development of new technologies: "[s]ince, by definition, there is no history on which to forecast demand for services which address new markets, investors in advanced telecommunications are often forced to proceed on several fronts with no advance knowledge of which new services will be met with positive consumer reaction." Rprt. to Gov. at 10.

efficiency. Improved production efficiency would not lead to an increase in profits except to the extent there is regulatory lag.

Moreover, the resource intensive nature of cost based regulation "will place a substantial drain on both the resources of the Commission and interested parties."

> [I]f the regulatory regime the Commission imposes will be transitory, it may not make sense to embark on a lengthy, complicated and costly process to accurately true up rates. Indeed, a danger exists that in the time it takes to true up rates that a "cost based" price cap regulatory regime may be obsolete. OII at 22-23.

The OII recognizes the problems inherent in the valuation of spectrum and developing capping mechanisms for geographic markets. OII at 21.[125] The time consuming proceedings required for cost based regulation cannot keep pace with technological and competitive changes.[126] Such a time lag is not a mere inconvenience; it will drive the regulated carrier out of business and thereby undermine, rather than enhance, competition. In light of the many deficiencies of cost based regulation, the Commission has concluded that "rate of return regulation would be neither efficient nor workable for cellular carriers." D.90-06-025 at 16.

There is simply no justification for retreating from the prior conclusion that cost based regulation is not appropriate. Recently, the Commission rejected DRA's "price cap" proposal for AT&T. See

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125 Additionally, public disclosure of a carrier's sensitive cost data will provide the "nondominant" service providers with a significant advantage. See Cellular Telecommunications Industry Association Petition for Waiver of Part 61 of the Commission's Rules, 8 F.C.C.R. 1412, 1413 (1993) ("Cost support materials might provide competitors with access to information that is competitively sensitive.")

126 The Commission has observed that public sector decisionmaking is inevitably slower than private sector innovation as a result of due process requirements. Rprt. to Gov. at 26.

D.93-02-010. The Commission concluded that the Observation Approach, approved in D.88-12-091, was a move away from traditional rate of return regulation by allowing AT&T limited upward and downward flexibility and that DRA's proposal was a

> retreat from the Observation Approach. Instead of lessening the need for data and analysis, DRA's proposal would create the need for the Commission to establish a starting revenue requirement, and to hold hearings regarding disputes about changes in productivity. Although DRA refers to its proposal as a price cap and incentive mechanism, it is essentially centered around a rate of return. Id. at 61-62 (emphasis added).

Similarly, the OII proposes a price cap mechanism "centered around" a rate of return. Such restrictive regulation is even less appropriate in the wireless marketplace with the speed of competitive entry and technological innovation.

There is no evidence to suggest that a change should be made to the Commission's prior findings that cost of service and rate of return regulation are inappropriate for cellular. Nor has there been an evaluation of the potential economic penalties of such regulation in light of new market conditions. To the contrary, the entrance of viable new competitors demonstrates that such restrictive regulation is even less appropriate now. The Commission has observed that

> . . . [w]here healthy competition exists, no significant purpose is served by continued government intervention. We believe aggressive streamlining of regulation will lower the cost of doing business in the state and shorten the time required to introduce new services. Rprt. to Gov. at 14.

Regulation has increased, rather than decreased prices in California. Imposition of even more anticompetitive regulation based on this record will only further harm consumers, ironically, when the multi-competitor market is at hand.

2. Price caps at existing rates is an unnecessary restraint on competition.

One possible alternative presented in the OII is a cap on cellular wholesale rates at existing levels. This model provides an incentive to lower prices by granting the regulatory flexibility to raise prices up to the price cap without regulatory approval. As the OII notes, this price cap proposal "mirrors" the existing cellular regulatory framework, including the maintenance of an anticonsumer margin requirement. Price caps at current rates would not correct the "many inefficiencies and administrative difficulties of the existing cellular framework." OII at 20.

Price caps at existing rates would continue to protect inefficient competitors from true competition. Cellular carriers seeking to reduce rates under the price caps would still be burdened with ensuring that the resellers' profit margin incorporated into each rate element is maintained. Elimination of this artificial restriction to pricing flexibility certainly will not harm competitors as demonstrated by regulation of IECs. Despite the fact that IECs do not develop their price structures within the context of mandatory margin requirements, resellers of interLATA service have been able to compete effectively by purchasing in volume and reselling to smaller segments. There is no reason to maintain the artificial margin in the wireless market; however, price caps alone would not remedy this problem.

B. Relaxed regulation implementing a monitoring plan is most likely to achieve the goals of the Commission's competitive plan.

The history of the cellular industry in California demonstrates that regulation has failed. Relaxed regulation is the only regulatory framework that can keep pace with technological and competitive changes. This conclusion is consistent with the Commission's observations of the cellular industry:

> Increased competitiveness among cellular carriers and resellers is the most direct and appropriate means for achieving reasonable rates as the technology and markets continue to change . . . . Keeping in mind the intent to promote competition for a discretionary service, rates should continue to be based on the market. D.90-06-025 at 50, 59.

It is market competition, not regulation, that will set prices at the level where supply and demand naturally meet. See D.90-06-025, Findings of Fact 11, 12 at 93.

Regulatory oversight is sufficient to encourage competition. The margin between wholesale and retail cellular prices should be established by economic factors in the markets, not artificial constraints on competition. Customers are best served if carriers can decide freely and quickly which products to offer and which technology best suits which product. The current incentives to abuse the regulatory process by contesting tariff filings will be eliminated, and competition will increase.

The Commission should continue its role of providing a forum to air complaints and resolve disputes, to monitor the cellular industry via company reports, to assure reasonable interconnect offerings by landline companies, and to promote public safety, security and privacy. Additionally, the Commission can implement a monitoring program to oversee the evolution of the wireless industry in California and intervene if market forces are not sufficient to provide adequate levels of service to customers. The OII rejects the capacity monitoring program developed in I.88-11-040 on the grounds that the data available is insufficient to evaluate the market. OII at 11. The mere fact that the parties to I.88-11-040 disagreed over the efficacy of the capacity data is an insufficient basis to eliminate monitoring, in some fashion, as an effective tool to ensure competition. "The potential benefit to ratepayers of a competitive market should not be abandoned through regulatory inaction caused by a quagmire of uninterpretable information." 24 CPUC 2d at 550.

PacTel submits that an effective monitoring program can be developed to allow the Commission to measure market competition. Monitoring industry trends will provide a sufficient mechanism for detecting and correcting any failure of market forces to ensure competition. The Commission is not abdicating its responsibilities by simply recognizing the competitive realities that now exist in the wireless market. To the contrary, the Commission has used a monitoring plan successfully for this purpose.

In connection with assessing rate flexibility for AT&T, the Commission relied upon CACD's monitoring plan. CACD developed a monitoring plan, based on the submission of confidential data intended to detect changes in the status of the market competitors and customer service satisfaction. D.88-12-091, 30 CPUC 2d at 420. The Commission noted that it could not foresee the total impact of regulatory flexibility, but it could provide a safeguard.

> While we have no desire to shelter inefficient competitors, we do wish to promote effective competition. Monitoring trends in the entry and exit of competitors will help us assure that effective competition develops. D.93-02-010 at 56.

In this instance, a comprehensive monitoring program, in conjunction with continuing regulatory authority, will allow the Commission to protect consumers. The flexibility granted by the Commission can be altered based on the findings of the monitoring program.

In summary, there is nothing in the evolution of the cellular industry to warrant a reversal of the Commission's conclusions that competitive forces are the best means to ensure the vitality of wireless service. To the contrary, the growth of the industry warrants increasingly flexible regulation. The Commission cannot simply jettison its prior findings and conclusions without an examination of actual market conditions and the propriety of the regulatory alternatives. The parties should have an opportunity to explore through evidentiary hearings the economic and competitive consequences of regulatory alternatives.

V. UNBUNDLING OF CELLULAR SERVICE IS ECONOMICALLY INEFFICIENT AND CONTRARY TO FEDERAL STANDARDS.

(Appendix A, Questions 31, 32 and 35.)

The OII proposes to unbundle the "radio portion" of cellular carriers' service in order to minimize the scope of the "market bottleneck." OII at 27. The proposal is both unnecessary and inefficient. It is predicated on false assumptions regarding the structure of the market and alleged cost benefits of unbundling. Unbundling will require putting an inefficient cost structure in place that will be difficult to regulate for years to come. The proposal couples unbundling with cost based rate regulation which when introduced into a competitive industry, serves only to raise costs and prices, decrease economic efficiency, hamper future advances in technology, and increase regulation rather than competition.

A. There is no bottleneck monopoly to justify unbundling.

The basic premise for unbundling, i.e., the existence of a bottleneck, is simply wrong. As demonstrated in section III.A.1, *supra*, there is no bottleneck. Cellular carriers have competed in the dual carrier market structure for over ten years, offering customers a choice of service, quality and price.

Going forward, ESMRs and PCS will enter the market, thus further obliterating the alleged excuse for unbundling. Unbundling simply is not appropriate in a competitive marketplace where multiple wireless service providers offer consumers access to the radio spectrum. If unbundling is imposed, cellular service will become less competitive because of an uneconomic added layer of costs created by a reseller switch. Imposing a select unbundling obligation on cellular service providers with no concomitant obligation on other wireless providers will place cellular carriers at a disadvantage and impose inefficiencies on the marketplace.[127]

B. Unbundling is predicated on false assumptions regarding cost savings.

The OII asserts that unbundling of radio functions should be pursued on a "cost efficiency" basis. See OII at 28. However, unbundling will ultimately result in higher, not lower, costs in the provision of cellular service. These higher costs will need to be reflected in higher prices charged to customers. Contrary to the assertion in the OII, unbundling will not provide greater value to consumers. See OII at 28. It merely allows resellers to freeload off cellular carrier's investments.

Unbundling would lead to an increase in the costs of providing cellular service. The reseller switch would merely duplicate the MTSOs call recordation, number administration and billing functions. It will

127 See Hausman Affidavit at 25-28; Geodesic II Report at 4115-4116 (extending equal access obligations beyond the landline bottleneck into competitive mobile radio services produces anticompetitive effects).

not relieve the carrier's switch of these functions.[128] Moreover, the carrier will incur the additional cost of providing services for the reseller switch. Thus, unbundling would lead to a loss of economic efficiency and to higher prices for consumers since cellular carriers' costs (aside from LEC interconnection costs) will not decrease by as much as their revenues because the costs of servicing the reseller switch will be higher. Additionally, resellers will charge an inflated price which reflects the cost of access to a network that they have not built, operated or maintained. Commission policy should promote economically efficient production, rather than protection of inefficient competitors. Finally, as a practical matter, unbundling will require extensive and lengthy proceedings. Thus, regulatory costs would be significantly increased, further compounding the net cost increase from unbundling.

C. Unbundling needlessly protects a select group of competitors.

Each competitor has certain possible advantages which it brings to a market. Individual competitors should neither be favored nor hindered in establishing the conditions for competition. Fair competition exists as long as providers have access to customers and vice versa. Resellers and retailers currently have such access and operate in a competitive market.

In contrast, unbundling requires cost based regulation amounting to a direct and unearned transfer of capital from carriers to resellers in

128 The carrier will avoid insignificant landline interconnection costs, but from the perspective of the consumer there is no cost saving since the reseller will simply take over paying these costs.

order for the reseller switch to make economic sense.[129] At the same time, cost based regulation will have serious negative efficiency consequences for the wireless market and cellular consumers. Competition should not be subverted at the expense of consumers by imposition of cost based regulation to subsidize the reseller switch. Prices should not be regulated so that less efficient middlemen (the resellers) can cover production costs. Instead, customers should receive the benefits of efficient production resulting from true competition between cellular carriers and other facilities based carriers. There is no justification to create pseudo reseller competition through a subsidized switch. The FCC is now allowing for increased competition in mobile telecommunications through ESMRs and PCS. Given that there is no barrier to entry into the market, resellers are certainly free to bid for ESMRs systems or to build PCS networks in the future. If they are successful, they will receive the rewards for their risks. Thus, there is no reason to grant favoritism to resellers.

D. Unbundling undermines the incentives for innovation.

The subsidy of cost based regulation necessary to support reseller interconnection is misguided because it is the carriers who have taken the risk of the investment in cellular systems. The return for that investment and further innovation is appropriately left with the carriers, as the Commission recognized in Phases I and II of the Cellular OII. Cellular carriers took considerable risk in constructing their networks, and have never been guaranteed a return on their investment. The reseller switch would merely mimic cellular carrier

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129 In Phase II of the Cellular OII, the resellers asserted that their switch could only make "economic and competitive sense" if cost based regulation is imposed. See Cellular Service Inc.'s Phase II Opening Comments, August 11, 1989, at 1.